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No. 01-442

IN THE

Supreme Court of the United States

CAROLE KEETON RYLANDER, Comptroller of Public Accounts of the State of Texas, and JOHN CORNYN, Attorney General of the State of Texas,

Petitioners,

v.

THE DOW CHEMICAL COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE THIRD COURT OF APPEALS OF TEXAS

BRIEF OF AMICUS CURIAE

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INTEREST OF *AMICI CURIAE*

Amici Curiae State of Nevada, and ten other States, have a vital interest in this case, as it implicates the ability of States to regulate and tax the business of insurance, and affects the uniformity and consistency of that taxation between the States. *Amici* are concerned with the uncertainty created by State court decisions such as the one being appealed here as to the scope of State authority to regulate and tax the business of insurance. The States have been working towards establishing a nationwide allocation system for insurance taxes, which includes taxes based on the location of the risk or the location where the risk is to be performed. State taxes paid on insurance premiums constitute a large source of revenue for the States. In Nevada, this is the third largest source of state tax revenue. All States have the same interest in rationally balanced revenue sources and in promoting fairness in their licensed insurance markets. At this time in our nation's history, sources of revenue are more important than ever.

Due process jurisprudence has evolved through the years since the Court's decision in *State Board of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451 (1962). This Court's more recent decisions construing the McCarran-Ferguson Act have also demonstrated evolution in the application of that act. Based on the changing economic realities of the insurance business and today's commerce, the holding in *Todd Shipyards* should no longer be rigidly applied to States' regulation and taxation of insurance.

Without clarity and certainty about *Todd Shipyards*' current validity, uncertainty now exists as to the ability of a state to tax insurance premiums based on the location of the risk or its place of performance. *Amici* believe that *Todd Shipyards* should be expressly overruled to clear up any doubt as to the current status of the jurisprudence of due

process as applied to the taxation and regulation of insurance. However, if location of the risk alone is not sufficient to allocate taxable value to a taxpayer with nexus, then the States need guidance as to what other allocation could be used.

SUMMARY OF ARGUMENT

Over two-thirds of the States impose a tax on insurance premiums based in some manner on the location of the insured risk in that state. Many states, like Nevada, impose a tax on the premium paid by the insured when the insured procures insurance outside the state from an insurer unauthorized to transact business in that state. These states look to the connection of the insured with the taxing state, the revenues obtained in the State by the insured related to the risk, and to the protections and benefits offered to the insured and the insured's property, to determine the constitutional limits of taxing the insured on the insurance premiums paid to the insurer. This process is commonplace in most states, and works well, as the location of the risk or the performance is a fairly easy determination to make. If *Todd Shipyards* is interpreted as the Texas Third Court of Appeals did in *Dow Chemical Co. v. Rylander*, 38 S.W.3d 741 (Tex. Ct. App.-Austin 2001, pet. denied), this process will be thrown into disarray and uncertainty.

Basing the tax on the location of the risk or its performance is logical, as the location of the risk or its performance can readily be ascertained. If the policy is insuring multi-state risks, the premiums and tax can be properly allocated among the involved states. Additionally, where the insurer is not authorized to transact business in the taxing state, but the insured has sufficient contacts with the taxing state for the taxing state to have jurisdiction over the insured, it makes sense to have the insured pay the premium tax directly to the state. The insured is the one with the ultimate burden of paying an insurance premium tax

regardless of whether the tax is remitted by the insured directly to the state or the tax is collected and remitted to the state by the insurer.

The States have been moving towards a more uniform system of insurance regulation and taxation that is based on the location of the risk. Finding a way to rationally balance revenue sources while promoting fairness in licensed insurance markets brings benefits to the States, by giving more certainty to amounts of revenues, while bringing certainty to insurers as well. Additionally, these benefits also inure to the consumers of insurance. When there is more certainty, there are more efficiencies that reduce the ultimate obligation to the consumers.

However, the strict application of the holding in *Todd Shipyards* to today's insurance markets creates a result that actually frustrates the movement toward uniformity. At the very least, the application of *Todd Shipyards* in the case below causes uncertainty, as other state courts have found the holding of *Todd Shipyards* inapplicable to certain insurance transactions or policies. Additionally, other courts have found that *Todd Shipyards* has been abrogated by subsequent decisions of this Court dealing with due process and the McCarran-Ferguson Act. Therefore, *Todd Shipyards* should be expressly overruled or at the very least limited to those circumstances where the taxpayer does not have sufficient contacts with the taxing state to satisfy Due Process concerns. However, such a limitation should not prevent the Court from overturning the lower court's decision as to the facts of this case, as the insured and the subject of the tax did have sufficient contacts with Texas, the taxing state, for the imposition of the tax at issue.

ARGUMENT

I. THE TEXAS COURT OF APPEAL'S DECISION CONFLICTS WITH THIS COURT'S DUE PROCESS JURISPRUDENCE.

In *Todd Shipyards*, the Court held that Texas did not have the power to impose an insurance premium tax upon the insured, where the insured risk was located in Texas, but the insured and the insurer were not residents of Texas. The Court applied a formalistic analysis, looking to the contacts of the insurer with Texas, and where the insurance "transactions" took place. The insurance agreement was negotiated and paid for outside Texas, the policies were issued outside Texas, and all losses arising under the policies were adjusted and paid outside Texas. The insurer had no office or place of business in Texas, did not solicit business in Texas, had no agents in Texas, and did not investigate risks or claims in Texas. Based on these facts, the Court held that taxing the nonresident insured in these circumstances violated the due-process clause.

However, since that decision, this Court's development of due process jurisprudence has shifted away from a formalistic analysis to one more flexible and practical, one that could take into account the economic realities of the insurance business. The Court set aside the formalistic rule of prohibiting the taxation of interstate commerce if the incidence of the tax was on the "privilege of doing business." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Then the Court took another step in the same direction when it made a clear distinction between a due-process analysis and a commerce-clause analysis, and rejected the prior holding in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967), regarding the requirement of physical presence in the state as

a prerequisite to the right to tax pursuant to the due-process clause. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

In *Quill*, the Court clearly stated that the test for due process analysis was only that a corporation have "minimum contacts" with the taxing state. *Id.* at 306-309. The intent of the Due Process Clause is to ensure fairness and notice to the corporation that its contacts with the State cause it to be subject to tax. *Id.* at 308. The presence in a state necessary to satisfy the Due Process Clause is comparable to that needed to support a state court's jurisdiction over a defendant in a civil matter. *Id.* at 307-308. As articulated in cases such as *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985), that standard is met if the entity purposefully directs its activity into a jurisdiction. *Quill* further clarified that a corporation "may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause." *Quill* at 313.

The Court has stated that the purpose of due process requirements is sufficient notice to the taxpayer that it will be taxed. *Quill* at 308. In the case being appealed here, the State of Texas is not placing a tax on someone who did not have nexus with the state. Instead, the insured has substantial contacts with the taxing state, and hence the taxpayer has sufficient notice that it is subject to Texas' taxing jurisdiction. The taxing state has a legitimate interest in regulating the insurance industry for the protection of its residents, as to the security of the insured, but also as to any other residents who may be the ultimate beneficiaries of a claim against the insured's insurance company. *See, e.g., Gage & Tucker v. Director of Revenue*, 769 S.W.2d 119, 126 (Mo. 1989), where the court found sufficient connection in the contract between the insurer and the taxpayers/insureds and the state to find due process was not violated by the assessment of a tax imposed on the insured.

It is the insurance on an insured risk that is having its value taxed. The risk is present in the taxing state. The State's power to tax an individual's or a corporation's activities is justified by the protection, opportunities and benefits the State confers on those activities. *Allied Signal, Inc. v. Dir., Div. Of Taxation*, 504 U.S. 768, 778 (1992). The state confers benefits upon the insured, as related to the insured risk, "by the fact of being an orderly, civilized society." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). The state has given opportunities, protection, and benefits related to the insured risk by affording access to its courts for both the insured and any possible victims that would have a claim against the insured. The state also affords protection to the insured risk through its law enforcement and fire departments, and provides the general benefits of maintaining an orderly society.

An owner of property should give appropriate support to the government that protects that property. *Virginia v. Imperial Coal Sales Co., Inc.*, 293 U.S. 15, 20 (1934). Here, the insured risk is located in the taxing state. The insured is being taxed on the insurance covering these risks because the real economic value of the insurance is as inextricably connected with Texas as the property and business interests being insured. The insured has purchased intangible rights protecting its property and business interests in Texas. The duty owed to the government "is not less when the property is intangible than when it is tangible." *Id.*

The value being taxed in this case is extremely important to businesses and to States. The modern trend in due process jurisprudence is to allow taxation based on the location of the insured risk in this case, as the insured and the insured risk have more than sufficient "minimum contacts" to meet due process concerns.

II. STATE COURT DECISIONS CREATE UNCERTAINTY AS TO THE STATE OF LAW ON TAXATION OF INSURANCE AND GUIDANCE IS NEEDED FROM THIS COURT.

It is imperative for the States that the current state of law regarding the taxation of insurance be clarified. State courts have interpreted *Todd Shipyards* in a variety of ways, and sometimes based on distinctions that seem meaningless in today's world. *Compare Dow Chem.*, 38 S.W.3d at 745 with *Associated Elec. & Gas Ins. Serv. v. Clark*, 676 A.2d 1357, 1361 (R.I. 1996), and *Lakehead Pipe Line Co., Inc. v. Amer. Home Assurance Co.*, 981 F. Supp. 1205, 1214-15 (D. Minn. 1997). Shortly after this Court decided *Todd Shipyards*, one state court stated that *Todd Shipyards* should not be read as forever limiting state regulation to the type existing at that time and forever barring expansion of the regulation of the insurance industry by states to meet the ever-growing social needs and problems of modern civilization. *Ministers Life & Casualty Union v. Haase*, 141 N.W.2d 287, 292 (Wis. 1966). This was in 1966, only four years after T*odd Shipyards* was decided. How much more true today is it that the concept needs to be flexible, and must be adjusted as the world changes, not forever fixed in one spot for several decades.

The Rhode Island Supreme Court has concluded that *Todd Shipyards* has been superseded by this Court's holding in *Quill* and state cases that distinguished *Todd Shipyards*. *Associated Elec. & Gas Ins. Serv. v. Clark*, 676 A.2d 1357, 1361 (R.I. 1996). *See also Howell v. Rosecliff*, 245 A.2d 318, 324 (N.J. 1968) ("[i]nsurance is so essential a part of the area of a State's primary responsibility that the State's power should not depend upon where the parties choose to contract for the insurance or to pay the loss. The State's interest and its responsibility to its citizens should be enough to support regulation and taxation of policies relating to the risks within

its jurisdiction"); *People v. United National Life Ins. Co.*, 427 P.2d 199 (Ca. 1967), *appeal dismissed for want of a substantial federal question*, 389 U.S. 330 (1967) (if there were any activity within a State either in the making or in the performance of the contract, the State could exercise its governmental powers to further its undoubted interests in insurable risks within its borders.)

If the Court does not expressly overrule *Todd Shipyards*, the very least that is necessary is guidance as to how the holding in that case applies to insurance contracts today that may have many different aspects, occurring in several different states.

III. THE CHANGES IN BUSINESS, COMMERCE AND INSURANCE REQUIRE OVERTURNING OR AT LEAST MODIFICATION OF THE HOLDING IN *TODD SHIPYARDS.*

The business of insurance changed when the mobility of people, companies and property increased, and also when ease of communications of several different types also increased. These factors militate against looking at where contracts are negotiated, from where payments are made, and whether the insurer must investigate claims in the taxing state. Instead, the easiest method of determining what state should tax the insurance is basing it on the location of the risk or location of its performance, as most states do.

Both before and after the Court's decision in *Todd Shipyards*, the Court recognized the importance of states' interest in the taxation and regulation of insurance and also the fact that insurance activities are not confined to just within one state's boundaries. *See Osborn v. Ozlin*, 310 U.S. 53, 62 (1940) (a state has a legitimate interest in all insurance policies protecting its residents against risks, an interest which the state can protect even though the state action may have repercussions beyond state lines); *Hoopeston Canning*

Co. v. Cullen, 318 U.S. 313, 316 (1943) (great weight should be given to the consequences of the contractual obligations in the state where the insured resided and the degree of interest that the state had in seeing that those obligations were faithfully carried out); *Travelers Health Asso. v. Virginia*, 339 U.S. 643, 647-648 (1950) (the Court stated where insurance business activities reach beyond one state and create relationships and obligations in another state, courts should not have to resort to fictions in order to sustain jurisdiction); *Clay v. Sun Insurance Office, Ltd.*, 377 U.S. 179, 182 (1964) (the Court recognized that insurance companies do not confine their activities and obligations within a particular state's boundaries).

The insurance industry is already moving towards the direction that is being asked by the petitioner, as this also appears to be the trend of the Court in its decision on due process. Therefore, the concerns that were compelling to the Court when it decided *Todd Shipyards* 40 years ago are not the same today. "[I]t is impossible to compare our present world to the one that existed at a time when the business of insurance was believed to be beyond the reach of Congress' power under the Commerce Clause." *United States v. Fabe*, 508 U.S. 491, 508 (1996). The petitioner was not allowed "to turn back the clock." *See id.* The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 445 (1940). "We must be on guard against imprisoning the taxing power of the states within formulas that are not compelled by the Constitution but merely represent judicial generalizations exceeding the concrete circumstances which they profess to summarize." *Id* at 445.

The fact that the insurance industry has tried to provide a uniform method for taxation of insurance

premiums indicates a concern for being consistent, which is met where the States base their tax upon the location of the risk. When States are confined to trying to determine if any part of the insurance "transaction" took place in a particular state, such as where was the insurance negotiated, where were the policies issued, where are losses adjusted and paid, does the insurer have an obligation to investigate a claim in that state depending on the type of insurance policy, uncertainty is created as to the proper allocation of the tax. However, basing the tax on the location of the risk is the most certain and efficient way of determining where it is appropriate to regulate and tax. In negotiations, it is difficult at times to determine where it was negotiated, especially when negotiated by mail or via the Internet, or it could be negotiated in more than one state. The facts of each situation may be difficult to determine or to prove.

The Court in *Todd Shipyards* stated that it had the freedom "of course" to change its decisions on the constitutionality of laws. *Id.* at 457. However, the Court felt constrained by the legislative history in light of the fact that the insurance industry had relied on this policy since 1897. The Court stated that it had been advised how severe the impact of a change of policy would be on small insurance companies should the old rule be changed. Based on these facts, the Court was "loath" to change the validity of specific prior decisions. *Id.* at 457. Here, however, the States have moved towards a uniform method of taxation of insurance, based on the location of the insured risk. A more uniform method of taxation will benefit the insurance industry as well as the consumers of insurance when certainty is created, and thus ultimately more efficiency in the administration of insurance, both by the States and the insurers.

IV. PRACTICAL ECONOMIC REALITIES REQUIRE THE OVERTURNING OF *TODD SHIPYARDS.*

As far back as its decision in *Pennoyer v. Neff*, 95 U.S. 714 (1878), this Court recognized that rigid categories for due process analysis cannot accommodate some necessary litigation. The Court has made adjustments over the years as deemed necessary to accommodate changes in our world. The advent of automobiles, which increased the incident of individuals causing injury in states where they were not subject to in personam actions, was one reason for modification of the territorial limits on jurisdictional power. *Shaffer v. Heitner*, 433 U.S. 186, 202 (1977). The Court found that the test of "fair play and substantial justice" should be applied. *Id.* at 206.

In *Complete Auto*, the Court found that the "Spector rule" had no relationship to economic realties, and was unsatisfactory in its operation in recent cases. *Complete Auto*, at 279, 285. The Court overruled the rule of *Spector Motor Service* that a state tax on the "privilege of doing business" is per se unconstitutional when it is applied to interstate commerce, and the case was overruled. *Id.* at 288-89. In *Quill*, the Court noted that Due Process jurisprudence has evolved in the 25 years since *Bellas Hess*. *Id.* at 306-07. The Court looked to "modern commercial life" and modified its holding in *Bellas Hess* because of developments in the law of due process. *Id.* at 308.

Here, we have the principles of *Todd Shipyards* being applied 40 years later. Here, "commercial life" requires the prior holding of Todd Shipyards to be overruled as it has been superseded by new developments in constitutional law. *See Quill* at 308; *Todd Shipyards* at 457. At the very least, the States need guidance and direction of how to properly allocate tax on insurance if the location of the risk or its

performance is not the most appropriate basis for the taxation.

CONCLUSION

For the reasons stated above, *amici* join in the petitioner's request that the petition for writ of certiorari be granted.

Respectfully submitted,

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